PUBLICITY OF ACCOUNTS OF INDUSTRIAL CORPORATIONS

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Citizens of the United States are facing the proposal to undertake national regulation of all corporations doing an inter-state business. It is proposed that this extend to all their operations, i.e., be not confined to their inter-state business. This is to be secured by requiring them, as a condition to license to do an inter-state business, to incorporate under a federal charter, thus making themselves subject to the control of congress in all respects. Thereupon, a commission is to supervise and regulate the company's operations.[1]

There is, of course, much opposition to the inauguration of such a plan. It is certainly a great departure from the traditional character and limitations of our general government. Its constitutionality is denied; its tendency toward centralization condemned. Its efficiency also is questioned, in that even the most tyrannical of bureaus could hardly maintain espionage upon all the industries of the country.

Yet all who earnestly and even strenuously oppose, must concede that a remedy for certain glaring evils must be found and that, if no other appears, the American people will accept and adopt national supervision.

[1] The following is this program as announced by Mr. George W. Perkins, in *The New York Times*, March 15, 1912:

"First—Create at once, in or out of the Department of Commerce and Labor, a business court or controlling commission composed largely of experienced business men.

"Second—Give this body power to license corporations doing an inter-state or international business.

"Third—Make such license depend on the ability of a corporation to comply with conditions laid down by Congress when creating such commission and with such regulations as may be prescribed by the commission itself.

"Fourth—Make publicity, both before and after the license is issued, the essential feature of these rules and regulations. Require each company to secure the approval of said commission of all its affairs, from its capitalization to its business practices. In the beginning, lay down only broad principles, with a view to elaborating and perfecting them as conditions require.

"Fifth—Make the violation of such rules and regulations punishable by the imprisonment of individuals rather than by the revocation of the license of the company, adopting in this respect the method of procedure against National banks in case of wrongdoing."

The real question, then, is whether there is another and a better plan; for assuredly we are not going to do without some plan.

Publicity of the accounts of corporations, which President Hadley, of Yale University, put forward more than a decade ago, as a way out, is involved in this more extensive program. Before venturing to adopt the whole of it, therefore, we may well consider whether effectual publicity alone might not answer as well or, indeed, better.

The publicity required is the simple, straightforward, intelligible type, covering essential matters so that the public may judge. Where autocratic, arbitrary regulation is found, the publicity features, while manifold and complex, are rarely illuminating and usually cause the public to lean more helplessly upon the supervising authorities.

It must have been considered that long study or the operation of these plans in connection with insurance and especially life insurance would perhaps enable me to lay before you some facts that would prove pertinent and applicable in respect to industrial corporations; else I should not have been invited to address you.

As regards life insurance, for instance, we have had about fifty years of state supervision in this country, relieved in recent years by a modicum of true publicity; while in Great Britain they have had about forty years of publicity, unaccompanied by supervision.

Our laws regulating life insurance were inaugurated in 1858 by the appointment of commissioners in Massachusetts to report upon the conditions in general. The very first act of this commission was to adopt and enforce an artificial and arbitrary method of computing the contingent liabilities of companies under running policies which later, upon the authority of America's greatest actuary, was the chief factor in causing the ruin of many American companies that were in fact solvent and need not have failed.

The idea of suppressing practices, which were very rightly condemned, by means of vigorous supervision thus found lodgment; and the ablest and most active of the commissioners was continued as sole commissioner. Soon afterward New York provided for a superintendent of insurance. Other states followed with laws regulating life insurance and providing for a commissioner or superintendent.

One thing is at once noteworthy: The failures of American

companies followed the introdution of supervision and, as said, was largely due to it, while the failure of British companies preceded the publicity measures of the government and there have been none or virtually none since.

As regards solvency and strength, the British idea has been to require reports, clearly stating the facts, thereby giving due advantage to the strong and prosperous, but encouraging the managers of weaker companies to work out their salvation by the best means available. The American method, always resulting in case a company gives up after a struggle, in a reflection on the supervising department for not closing it sooner, encourages the spirit of distinct and even marked favor for the old and strong companies and of disfavor for the new and small companies.

Thus for years the interpretation of our reserve laws by supervising officers actually prohibited the successful launching of new companies, thus automatically giving to a constantly diminishing number of companies a virtual monopoly of the field. This has been relieved in some states as to life insurance, but is yet true in all of them as to fire insurance. A great object lesson in the desirability of room for the exercise of expert judgment in this matter, which has been a cardinal feature of the British Act, was recently given in New York where, by reason of a lower standard to test mere solvency, as distinguished from the right to do new business, a large life insurance company was saved from a receivership and in a year or so its entire impairment restored. Yet such was heresy in America a few years ago; and is not provided for even now in other states.

As regards strength and solvency, then, the effect of the supervision method generally has been to make conditions hard or even impossible for the new and small companies and, by applying an unyielding and often wholly unsuitable reserve standard to them, drive them out of existence; while publicity has nursed them when weak, and, by affording means for suitable and significant comparisons, has encouraged them to strengthen themselves.

A feature, scarcely if at all less important than solvency, which is sought to be safeguarded by these legislative measures, is that companies really perform good service for the public, i.e., as regards life insurance, for instance, supply insurance at the least cost compatible with safety and otherwise on the best terms.

The earliest work of the Massachusetts commissioner, after

setting up a standard of reserve, was to advocate and ultimately to secure legislation requiring Massachusetts companies to give (in the form of keeping the insurance in force for the time it would pay for) a value equal to a large part of the reserve, upon surrender or lapse. Such relief was undoubtedly grievously called for, since companies were actually forfeiting fully paid-up dividend additions upon non-payment of premiums. The commissioner and the legislature, of course, did not consider publicity a cure; therefore, mandatory legislation.

The Massachusetts companies complied, but most unwillingly; and, after some years, they succeeded in changing this, first, to guaranteed cash values and, later, to a choice, by the company, to provide for paid-up or extended insurance, with an option of cash values. It was many years before automatic extended insurance was generally given; and when it was, this was due to the energetic competition of a company, the officers of which believed in it and, therefore, offered it, wholly without legal compulsion.

As regards cash surrender values, also, it was fidelity to the feature as a matter of principle, on the part of two companies in the United States and one in Canada, professionally advised by this Massachusetts commissioner, and not to companies, acting under compulsion of law, that finally brought it into favor.

This took a long time, also—a very long time—during which a monstrous scourge of misrepresentation, deceit and fraud fell upon the United States, before the right to surrender value was conceded. This scourge, singularly enough, proceeded from a plan to *forfeit* reserves, i.e., to allow nothing upon surrender or lapse. The outcry in order to secure surrender value legislation had, of course, emphasized the "outrageous" gains from forfeitures. So "Tontine" was introduced with its estimates of impossible gains to be made by taking a forfeitable policy, continuing it in force for ten, fifteen or twenty years and so sharing in the reserves forfeited by others. These were urged upon the public by agents, under offers of commissions which, after a time, represented a waste greater than any possible gain from this source.

Whatever may be thought of the forfeiture system, itself, under which from fifty to sixty per cent of the insured lost their equities, there can be no question that the campaign of lying estimates, distorting life insurance into a "hot air" speculation, constitutes a continuing

reproach upon the good name of American life insurance, a reproach not yet removed in many of the states.

The degree of it may be judged from this: Before the Armstrong Committee, we showed that three of the New York companies, making big estimates of returns on "tontine" policies, were so wasteful that they were earning virtually nothing for them; that is, they were charging for policies which were really non-participating, full-participating premiums, about twenty per cent higher than non-participating, and were hiding this by lying estimates. The extent of it may be judged from this: The officers of the New York company which is generally considered to have come out best in the investigation, were compelled to acknowledge that a rate-book, showing actual results on such policies, had been withdrawn and another with materially higher "estimates" supplied, because the agents had insisted they could not sell the insurance by presenting the facts.

This grew up under a system of supervision of increasing severity and complexity. In Great Britain under publicity only, the sole sinners in this regard were the branches of our American companies, to deal with which their publicity measures, planned only for their own home conditions, were then inadequate. On the part of British companies, since 1870, "make good" has been the rule, and unrealized estimates a negligible exception.

In this important regard the publicity required in Great Britain was merely filing with the "Board of Trade," a government department, full information as to "bonuses" i.e., dividends to policyholders, giving examples of the rates of bonus and the factors or method by which they were arrived at. No such requirement was made in the United States prior to the Armstrong laws of New York, enacted in 1906, i.e., nearly fifty years after the advent of supervision.

The one unfortunate omission from the British "bonus" requirements was provisional accounting as to accumulations of surplus prior to completion of the dividend period. The absence of this, due to the fact that British companies "divided" their surplus at the end of fixed periods among policies of whatever duration, while the "tontine" plan called for "apportionment" each year, but only to policies completing their periods, permitted a company to run on, using its lying estimates up to and beyond total failure to realize them. There, as here, there was no exposure of that.

This was sought to be remedied by the Armstrong laws also,

which provided for "a statement showing any and all amounts set apart or provisionally ascertained or calculated or held awaiting apportionment upon policies with deferred dividend periods longer than one year for all plans of insurance and all durations and for ages of entry as aforesaid (i.e., 25, 35, 45 and 55). . . ."

The New York department, however, though for the last three years deemed strict and even stringent in supervision, has never enforced this publicity feature, so absolutely essential to the protection of holders of policies of a "closed" class, i.e., a class no longer recruited. The failure to enforce was due to resistance and assurances that "it cannot be done," which statement is absolutely false.

This illustrates a favorite and almost unavoidable attitude of supervising state officers, viz.: "It is our business to supervise," with the result that the most important things, viz., the essentials of publicity, are lost sight of in the performance of arduous, manifold and complex duties, usually leading nowhere.

The two features of the Armstrong laws which have most made for improvement of the service to the public in quality and in cost, and that there has been marked improvement is shown by the fact that the rates of annual dividends to its policyholders paid by the oldest and largest company were more than three times as high in 1912 as in 1905, are these:

1. Publicity regarding rates of annual dividends.

2. Publicity regarding expenditures for new business, tested by a certain reasonable standard for the same, based upon experience and then introduced for the first time.

The first of these revealed unescapably whether or not a company was supplying life insurance at a reasonable cost; the second laid bare the chief among the evils which rendered the insurance costly.

"In what way may these facts conduce to a solution of the problem of regulating industrial corporations?" is a question which may well be asked.

Industrial corporations are subject to publicity requirements in Great Britain, similar to those applying to life insurance companies, though not identically the same. Though industrial development is more advanced there than in any other country, monopolistic manipulation of prices and the like are virtually unknown.

The industrial corporation problem seems to involve the same issues, fundamentally, as life insurance, but in a somewhat simpler

form. Life insurance companies are selling their promises to pay, of varying value because of difference in terms of contracts and in strength of companies; while industrial companies deal in material products, the value of which is known to buyers and is independent of the corporation's financial status. But their stocks and bonds are offered for investment, which leaves the situation much the same.

The aim of regulation of industrial corporations, then, is very similar to that of life insurance regulation, viz.: To promote solvency and protect buyers of stocks and bonds against imposition, by requiring simple and correct statements to be filed; and to encourage the performance of good service at moderate prices and discourage the contrary course.

That these things can as certainly be accomplished regarding industrial corporations, by wise publicity requirements, as in life insurance, is both obvious upon the face of it and also clearly shown by experience in Great Britain where false statements about corporate affairs are as infrequent as they are frequent here and commodities are supplied at lower prices than anywhere else in the world.

The door to the accomplishment of these things stands invitingly open, also. All these corporations are reporting to the comptroller of internal revenue now, every year. These reports can be classified and made public, whenever that course is decided upon. Were this done, in a perfectly simple and intelligible way, it would at once reveal both the corporations which are dangerous to investors, because not "making good," and those which are exacting an excessive profit by reason of monopolistic practices.

Publicity in the former regard would protect the public against the foisting upon them of stocks and bonds in losing ventures and would encourage better business practices and the strengthening of such corporations.

Publicity regarding excessive profits might be a complete cure in and of itself. If not, it would perhaps serve to indicate the source of such profit, as, for instance, by working through subsidiary corporations, etc., and thereby to give a hint how the evil may be reached. It might also show that the federal power of taxation should be invoked, to make extortion unprofitable by taking a heavy toll for the nation.

The sole penalties, then, would be:

1. Punishment of officers for making false statements. This

should apply also to circulating false statements. Punishment should be inexorably inflicted, usually by imprisonment.

2. Punishment of corporations and of officers for violation of statutes, both state and federal, revealed or indicated by the accounts as filed.

3. Heavy taxation of monopoly profits.

Our condition as regards reliable information concerning corporations is at the present time exceedingly unfortunate. There is no bureau to which the people of the country, whether consumers or investors, may turn to ascertain the financial operations and condition of the various corporations doing business here. Of course, as we have no provision for publicity of accounts save as to banks, trust companies and insurance companies, it follows that the wildest falsehoods are at times circulated about corporations for the purpose of depressing or booming their shares. The mendacity of the American promoter, whether engaged in floating a new corporation or in selling further securities of older corporations, is proverbial; and the honorable standard of "make good" which has been set by our strongest banking house in recent years is only beginning to have its influence to suppress such practices. We need, unquestionably, and that on a national scale, not so much the features of the "British Stock Companies Act," which prescribe the powers of corporations and make provisions for their incorporation uniform throughout Great Britain, but those features which require that a correct account be filed with the Board of Trade of London, and that every statement made by every such corporation, its agents, promoters, officers or directors concerning its affairs shall truly represent the facts.

It is perhaps doubtful whether it would ever be necessary to make use of the federal power of taxation, which, according to the precedents established by the courts, is limited only by the express limitations of the constitution and may be utilized within the discretion of congress, even if the result be to destroy, if effective publicity were once introduced; but, notwithstanding, it is well that that power exists. The punishment of taxing the "unearned increment" of a swollen profit, derived from monopoly, is obviously one which "fits the crime." It would also act as a preventive, inevitably, since that which there is no profit in doing, will in the nature of things not be done.

Over against this utilization of the powers of the federal government, which it indubitably possesses under the existing constitution, there is set a program which is being urged first and primarily by leading officers of one of the largest industrial combinations of our country and, as a close second, by one of the candidates for president and many of his supporters, viz., that we shall set up bureaus, clothed with supervisory powers, scarcely if at all second to those possessed by various bureaus in the Russian, the Austrian and the German empires, and really much more dictatorial in type, as it is presented by these advocates, than anything to be found in those countries. A prime essential, according to their conception of the function of such a bureau, is that it may pass *in advance* upon the regularity and propriety of proposed corporate action, thereby telling "business" what it may do and may not do, and also that it shall have power to fix prices or at least to pass upon their reasonableness.

For telling "business" what it may do, there is the precedent of the action of the same candidate for president when he was in office, a precedent also involving the other leading parties who advocate this method; but, while it seems to have worked satisfactorily for all of them up to the present time at least, it has by no means been satisfactory to the rest of the people and indeed is generally condemned.

For fixing prices, the precedent is urged of the powers of regulating railway rates exercised by the Interstate Commerce Commission, subject to an appeal to the commerce court. This feature, which has been so intensely unpopular with the railway companies in the past, has, by reason of court decisions, fair enough at that, that the rates must not be "confiscatory," i.e., must leave a fair margin, been more favorably viewed of late.

It is difficult to see how the government, as regards railways and the like, or states and municipalities, as regards certain other forms of public service, can avoid accepting this responsibility; but, on the whole, the people of the United States are not so satisfied with the results that they would desire to extend this power to pass upon all prices. Instead, proper publicity of accounts would show, as to many of these public service corporations, a condition of affairs quite as little satisfactory both as to quality of service and price, as the condition in regard to any of the industrial corpora-

tions; for, as respects these public service corporations, there is a natural monopoly, which has been a fruitful cause of extravagant earnings and inflated values.

In other words, the precedents are not such as give any fair reason for believing that, even if these things could be effectively introduced within the letter and the spirit of our constitutional restrictions, they would attain the object which we have in view.

The creation at Washington, as a bureau of the central government, of a department with which shall be filed for publication, as well as for taxation purposes, complete, simple, intelligible and significant accounts of all corporations, with power of investigation if there is suspicion that false statements have been made, and with at least the menace that legislation levying a discriminating tax will be resorted to if a corporation so conducts its business as to extort an unfair profit for the service which it renders, would seem, therefore, to be a perfect solution of the serious problem now confronting us; and it is all the more desirable, because it will leave the enforcement of the criminal laws to the regular prosecuting authorities, the utilization of the civil laws by private parties to their own initiative, and the constitution of the United States without amendment or violation of its letter or spirit.